

## Message Text

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PAGE 01 PARIS 16969 01 OF 06 270808Z  
ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08  
EA-10 FRB-03 INR-10 IO-13 NEA-11 NSAE-00 ICA-11  
OPIC-03 SP-02 TRSE-00 LAB-04 SIL-01 AGRE-00  
OMB-01 SS-15 /111 W  
-----005112 270847Z /12

R 270732Z MAY 78  
FM AMEMBASSY PARIS  
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INFO ALL OECD CAPITALS  
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PASS TREASURY, FEDERAL RESERVE, CEA

E.O. 11652: N/A  
TAGS: ECON, EFIN, OECD  
SUBJECT: EPC/TEMPORARY WORKING PARTY MEETING ON MAY  
24: BALANCE OF PAYMENTS AND FINANCING PROSPECTS OF  
SMALLER OECD COUNTRIES

REF: (A) CPE/TWP/A(78)1, (B) CPE/TWP(78)1 PLUS  
ADDENDUM AND CORRIGENDUM, (C) PARIS 14867 NOTAL

1. SUMMARY: MAY 24 MEETING OF ECONOMIC POLICY  
COMMITTEE'S TEMPORARY WORKING PARTY (TWP) REVEALED  
LITTLE NEW INFORMATION AND PRODUCED NO SURPRISES WITH  
RESPECT TO BALANCE OF PAYMENTS AND EXTERNAL FINANCING  
PROSPECTS OF SMALLER OECD COUNTRIES. TWP ENDORSED  
SECRETARIAT'S VIEW THAT SOME PROGRESS WAS BEING MADE  
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PAGE 02 PARIS 16969 01 OF 06 270808Z

TOWARD REDUCING SMALLER COUNTRIES' OVERALL DEFICIT  
BUT THAT IT WAS SLOWER THAN FOR LARGE COUNTRIES (I.E.,  
THEIR RELATIVE SHARE OF THE OVERALL OECD  
DEFICIT IS INCREASING). FASTER DOMESTIC GROWTH SEEN  
AS EXPLAINING LESS OF POORER PERFORMANCE IN 1978 THAN  
IN 1977 AND PREVIOUS YEARS. SEPTEL REPORTS DISCUSSION  
OF AGENDA ITEM ON FUTURE OF EXCHANGE GUARANTEE

AGREEMENT AND OF COMMITTEE FOR MONETARY AND FOREIGN  
EXCHANGE MATTERS. END SUMMARY.

2. OVERVIEW: SECRETARIAT (POTTER) INTRODUCED TWP  
DISCUSSION BY NOTING THAT CURRENT ACCOUNT (C/A) POSI-  
TION OF "SMALLER DEFICIT COUNTRIES" (AUSTRALIA, AUSTRIA,  
DENMARK, FINLAND, GREECE, ICELAND, IRELAND, NEW ZEALAND,  
NORWAY, PORTUGAL, SPAIN, SWEDEN, TURKEY) AS A GROUP  
REMAINED IN SUBSTANTIAL DEFICIT (-\$22.5 BILLION IN  
1976, -25.5 BILLION IN 1977, -\$2L.5 PROJECTED FOR  
1978) DESPITE SUBSTANTIAL REDUCTION IN OECD-WIDE  
DEFICIT PROJECTED FOR 1978 (-\$32 BILLION IN 1977 TO  
-\$15 BILLION FOR 1978). POTTER SUGGESTED FOUR REASONS  
FOR RELATIVELY POORER PERFORMANCE OF THIS GROUP:

A) ENERGY IMPORTS- ALTHOUGH NOT SUBSTANTIALLY MORE  
AFFECTED BY RISE IN OIL BILL, THEY HAVE BEEN ABLE TO  
OFFSET ONLY ONE-THIRD BY INCREASED EXPORTS TO OPEC,  
WHEREAS BIG-SEVEN HAVE OFFSET ONE-HALF.

B) TRADE PERFORMANCE - UNTIL 1977, RELATIVELY FASTER  
DOMESTIC DEMAND GROWTH AND RELATIVELY HIGHER INFLATION  
IN THIS GROUP KEPT TRADE ACCOUNT WEAK; PICTURE NOW  
LESS CLEAR AND FOR GROUP AS A WHOLE SECRETARIAT FEELS  
THESE FACTORS NO LONGER HAVE DOMINANT ROLE IN EXPLAIN-  
ING C/A WEAKNESS.  
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PAGE 03 PARIS 16969 01 OF 06 270808Z

C) TERMS OF TRADE ON NON-OIL TRADE - FOR PERIOD 73-77,  
TOT (NON-OIL) MADE POSITIVE \$30-35 BILLION CONTRIBU-  
TION TO BIG-7 C/A BUT NEGATIVE \$5 BILLION TO THIS  
GROUP - ATTRIBUTABLE IN PART TO EXPORT MIX (E.G.,  
PRIMARY PRODUCTS) AND MARKET ACCESS PROBLEMS.

D) INVISIBLES - FOR GROUP, INVISIBLE ACCT WORSENER  
BY \$8 BILLION (73-77) OF WHICH ABOUT \$5 BILLION ATTRI-  
BUTABLE TO DEBT SERVICING ON BORROWING TO FINANCE  
HIGH CUMULATIVE DEFICIT, REMAINDER PARTIALLY EXPLAINED  
BY SHARP FLATTENING OF WORKER REMITTANCES.

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PAGE 01 PARIS 16969 02 OF 06 270814Z  
ACTION EUR-12

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3. SECRETARIAT IDENTIFIED THREE CATEGORIES OF COUNTRIES  
WITH COMMON CHARACTERISTICS WITHIN GROUP (IN ACCOR-  
DANCE WITH DEVELOPMENTS SINCE 1973):

A) NORDICS AND AUSTRIA: 1) ATTEMPTED TO OFFSET  
FOREIGN DEFLATIONARY IMPULSE BY STIMULATIVE DOMESTIC  
DEMAND, POLICY PROVED INCREASINGLY DIFFICULT AND NOW  
GENERALLY ABANDONED; 2) "HARD CURRENCY" OPTION -- ALL  
HAVE UNCHANGED REAL EXCHANGE RATE OR REAL APPRECIATION  
OVER PERIOD 73-77.

B) SOUTHERN EUROPE: 1) INVISIBLES PARTICULARLY HARD  
HIT, PLUS EXPORT DETERIORATION, 2) HIGH INFLATION,  
3) REAL EXCHANGE RATE GENERALLY UNCHANGED, OR SLIGHT  
REAL APPRECIATION.

C) AUSTRALIA/NEW ZEALAND: 1) HIGH EARLY INFLATION  
ONLY SLOWLY COMING UNDER CONTROL, 2) REAL EXCHANGE  
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PAGE 02 PARIS 16969 02 OF 06 270814Z

RATE DEPRECIATION BUT EXPORTS DISFAVORED BY PRODUCT  
MIX.

4. AFTER INDIVIDUAL COUNTRY PRESENTATIONS (SEE BELOW  
FOR DETAILS), CHAIRMAN (VAN YPERSELE OF BELGIUM)  
SUGGESTED SUMMATION OF FOUR GENERAL THEMES WHICH  
WOULD BE REPORTED TO EPC, NAMELY:

A) OUTLOOK FOR 1978 INDICATES SOME IMPROVEMENT IN "SMALL COUNTRY" GROUP'S BOP SITUATION, ESPECIALLY AS THERE HAD BEEN SOME SHIFT OF DEFICITS TO COUNTRIES BETTER ABLE TO OBTAIN FINANCING (I.E., LESS CONSTRAINED BY EXTERNAL CONSIDERATIONS).

B) MEDIUM-TERM OBJECTIVE FOR MOST COUNTRIES IS NOT BALANCE ON EXTERNAL ACCOUNT BUT SMALL DEFICIT (IN RECOGNITION OF AREA-WIDE DEFICIT AND SECULAR CAPITAL/IMPORTER POSITION OF MANY IN GROUP); NEVERTHELESS GROUP DEFICIT STILL VERY LARGE.

C) DEFICITS ARE NOW DUE LESS TO HIGH GROWTH RATES; MORE TO DETERIORATION IN TERMS OF TRADE AND INVISIBLES (INCLUDING DEBT SERVICE) THAN WAS CASE TO 1979.

D) SOME STRUCTURAL, MEDIUM-TERM PROBLEMS STILL EXIST FOR THIS GROUP OF COUNTRIES. HOWEVER, IT IS CLEAR THAT THEY WOULD BENEFIT FROM CYCLICAL UPSWING OF TYPE OUTLINED IN OECD "CONCERTED ACTION" PROGRAM (FYI -- FRG DELEGATE, WHILE VOICING SUPPORT FOR "CONCERTED ACTION", SUGGESTED EMPHASIS SHOULD BE REVERSED, WITH STRUCTURAL PROBLEMS DOMINATING CYCLICAL ONES, BUT VAN YPERSELE REJECTED THIS .)

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PAGE 03 PARIS 16969 02 OF 06 270814Z

#### INDIVIDUAL COUNTRY PRESENTATIONS

5. TO FACILITATE REPORTING OF COUNTRY PRESENTATIONS, WE WILL KEY RESPONSES IN PARA 6 BELOW TO FIVE QUESTIONS POSED BY SECRETARIAT IN PARA 3 OF REF B AND SUMMARIZED AS FOLLOWS:

(A) DOES COUNTRY AGREE WITH SECRETARIAT'S CURRENT BALANCE FORECAST FOR 1978? HOW MUCH OF DIFFERENCE SEEMS DUE TO A DIFFERENT WORLD TRADE ASSUMPTION (SECRETARIAT HAS FORECAST 5 PERCENT GROWTH OF OECD EXPORTS)?

(B) IF MEASURES HAVE RECENTLY BEEN TAKEN OR ARE CONTEMPLATED, DIRECTED SPECIFICALLY AT CURRENT BALANCES, WHAT EFFECT ARE THEY EXPECTED TO HAVE ON (A) THE EXTERNAL POSITION AND (B) ON THE DOMESTIC ECONOMY? ANY REVERSALS FORESEEN IN THE NEAR FUTURE?

(C) WHAT PROPORTIONS OF DEFICIT EXPECTED IN 1978 ARE LIKELY TO BE FINANCED BY "AUTONOMOUS" CAPITAL INFLOWS, BY OFFICIAL AND SEMI-OFFICIAL BORROWING FROM

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PAGE 01 PARIS 16969 03 OF 06 270817Z  
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PRIVATE SOURCES, BY BORROWING FROM OFFICIAL SOURCES  
AND BY CHANGES IN NET RESERVES?

(D) AT PREVIOUS MEETINGS OF THE WORKING PARTY, MOST  
DEFICIT COUNTRIES FELT THAT THEIR CURRENT POSITION  
COULD BE "ACCEPTED" FOR THE MOMENT ASSUMING THAT THERE  
WAS SOME PROSPECT FOR REDUCTION OVER THE LONGER HAUL.  
HAVE COUNTRIES' VIEWS CHANGED ABOUT THE BUILD-UP OF  
INDEBTEDNESS?

(E) IF THE EXTERNAL CLIMATE WERE MORE BUOYANT THAN  
EXPECTED, WOULD GOVERNMENTS TAKE ADVANTAGE OF IT TO  
IMPROVE CURRENT ACCOUNT POSITIONS OR TO EXPAND DOMESTIC  
DEMAND?

6. AUSTRALIA

(A) GENERALLY AGREED WITH SECRETARIAT.

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PAGE 02 PARIS 16969 03 OF 06 270817Z

(B) HANDLED TOGETHER WITH (E).

(C) EXPECT SMALL INCREASE IN RESERVES DURING 1978, WITH CAPITAL INFLOWS OF ABOUT \$3 BILLION, DIVIDED ROUGHLY EQUALLY BETWEEN PROCEEDS OF GOVERNMENT BORROWING IN CAPITAL MARKETS AND AUTONOMOUS CAPITAL INFLOWS.

(D) AUSTRALIA TRADITIONALLY HAS A CURRENT ACCOUNT DEFICIT OF ABOUT 2-3 PERCENT OF GNP. THIS IS REGARDED AS NATURAL AND DOES NOT CAUSE ANY PARTICULAR CONCERN.

(E) THE QUESTION IS REALLY NOT APPLICABLE TO AUSTRALIA, SINCE POLICY CONSTRAINTS TO GROWTH ARE NOT EXTERNAL. CONSTRAINTS TO GROWTH ARE DOMESTIC AND INCLUDE IN PARTICULAR INFLATION, THE OVERLY HIGH WAGE SHARE IN NATIONAL INCOME, AND THE HIGH SAVINGS RATIO.

#### AUSTRIA

LARGE DEFICITS 75-77 PROMPTED POLICY MEASURES AIMED AT STOPPING C/A DETERIORATION (A) IN SHORT TERM BY SLIGHTLY RESTRICTIVE POLICY AND (B) IN LONGER TERM BY RESTRUCTURING TRADE ACCOUNT THROUGH MORE EMPHASIS ON INVESTMENT IN EXPORTS AND IMPORT SUBSTITUTION PROMOTED BY GOVERNMENT INVESTMENT INCENTIVES. US DEL SUGGESTED AUSTRIAN RESPONSE TO C/A DETERIORATION WAS STANDARD PRE-1973 POLICY LINE, BUT QUESTIONED WHETHER IT APPROPRIATE TODAY. (GERMANS AND BELGIANS ALSO POINTED TO EXCHANGE RATE POLICY AS CRUCIAL ISSUE FOR AUSTRIA.) AUSTRIAN DEL EXPLAINED THAT, FOR DOMESTIC STABILIZATION REASONS, AUSTRIA HAD DISMISSED EXCHANGE RATE ADJUSTMENT AS INFEASIBLE TOOL TO HELP RESTORE EXTERNAL BALANCE (EVEN IF ITS C/A PROBLEM WERE DUE LIMITED OFFICIAL USE

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PAGE 03 PARIS 16969 03 OF 06 270817Z

TO COMPETITIVE POSITION, WHICH GOA DOESN'T BELIEVE); ALSO NOTED AUSTRIAN IMPORTS WHICH HAD CAUSED C/A DETERIORATION, MAINLY LUXURY GOODS WERE NOT PRICE ELASTIC. RESPONSES:

(A) GENERALLY AGREE, BUT EXPECT MARGINAL IMPROVEMENT (\$2.8 BILLION VS SEC'S 3) DUE TO WEAKER IMPORT DEMAND. DEL CAUTIONED THAT EARLY 1978 C/A RESULTS SHOULD BE INTERPRETED CONSERVATIVELY SINCE SPECIAL FACTORS ARE AT WORK ON IMPORTS (ANTICIPATORY BUYING IN 1977) AND SINCE SUMMER TOURISM HAS MORE PROBLEMS THAN WINTER.

(B) DID NOT ADDRESS DIRECTLY, BUT NOTED THAT CERTAIN MEASURES (E.G., VAT INCREASE) WOULD FALL MOST HEAVILY ON IMPORTS.

(C) OF A. SCHILLING 27 BILLION FINANCING NEEDS, EXPECT 10 FROM OFFICIAL BORROWING, 7 FROM PRIVATE SECTOR,

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PAGE 01 PARIS 16969 04 OF 06 270820Z  
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10 FROM OFFICIAL RESERVE RUNDOWN.

(D) INDEBTEDNESS LEVEL OK, BUT INTEREST BURDEN BEGINNING TO PRESS.

(E) CURRENT ACCOUNT IMPROVEMENT.

DENMARK

DANISH REP DID NOT CONTRIBUTE MUCH NEW, NOTING DANISH POLICIES WERE DELIBERATELY DESIGNED IN THE PRESENT CONJUNCTURE TO REDUCE THE PROPENSITY TO IMPORT. HE INDICATED THAT IN THE EVENT INTERNATIONAL DEMAND WOULD INCREASE AS A RESULT OF "CONCERTED ACTION" DENMARK WOULD TAKE ADVANTAGE OF THE INCREASED STIMULUS PARTLY TO REDUCE ITS CURRENT ACCOUNT DEFICIT AND PARTLY TO

INCREASE DOMESTIC DEMAND.

FINLAND

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PAGE 02 PARIS 16969 04 OF 06 270820Z

(A) SECRETARIAT FORECASTS \$0.25 BILLION DEFICIT;  
FINLAND EXPECTS SMALL SURPLUS.

(B) NO RESPONSE (N.R.).

(C) PRINCIPAL OBJECTIVE, GIVEN REDUCED NEED FOR  
CAPITAL INFLOW, IS RESTRUCTURING DEBT TO LENGTHEN  
AVERAGE MATURITY.

(D) N.R.

(E) HAVE ALREADY SHIFTED TO SLIGHTLY MORE EXPAN-  
SIONARY POLICY, BUT WOULD NOT DO MORE EVEN IF WORLD  
TRADE MORE BUOYANT.

GREECE

NO SUBSTANTIVE INTERVENTION.

IRELAND

NO SUBSTANTIVE INTERVENTION.

NEW ZEALAND

DISCUSSION FOCUSED ON N.Z. TERMS OF TRADE LOSS OVER  
73-77 PERIOD. N.Z. DEL STATED 40 PERCENT TOT LOSS IN  
1973 WAS TREATED BY POLICYMAKERS AS NORMAL CYCLICAL  
SWING WHICH WOULD BE FOLLOWED BY TOT RECOVERY; THIS  
WAS, WITH HINDSIGHT, A MISTAKE SINCE NO SUSTAINED  
RECOVERY HAS OCCURRED. RESPONSES:

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PAGE 03 PARIS 16969 04 OF 06 270820Z

(A) SLIGHT DIFFERENCE, DEFICIT \$0.6 BILLION VS 0.9  
FOR SECRETARIAT.

(B) COVERAGE OF EXPORT INCENTIVE PROGRAM WIDENED IN  
FALL 1977, IMPORT DEPOSIT SCHEME SUSPENDED.



(C) 75 PERCENT COVERAGE BY AUTONOMOUS FLOWS, MAINLY PRIVATE FOREIGN INVESTMENT; REMAINING 25 PERCENT BY OFFICIAL BORROWING.

(D) NO PROBLEM WITH LEVEL OF DEBT, BUT LEVEL OF DOMESTIC ACTIVITY TOTALLY UNSATISFACTORY AND N.Z. POLICY IN MEDIUM-TERM AIMED AT REDUCING C/A DEFICIT ASSOCIATED WITH GIVEN LEVEL OF DOMESTIC ACTIVITY BY RESTRUCTURING PRODUCT MIX IN TRADE ACCOUNT.

(E) C/A IMPROVEMENT IF ACCESS PROBLEM CAN BE OVERCOME.

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PAGE 01 PARIS 16969 05 OF 06 270832Z  
ACTION EUR-12

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LIMITED OFFICIAL USE SECTION 05 OF 06 PARIS 16969

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NORWAY

(A) GON MORE OPTIMISTIC THAN SECRETARIAT ON 1978 CURRENT ACCOUNT BY \$0.4 BILLION. BELIEVES EXPORTS WILL GROW LESS REAPIDLY THAN SECRETARIAT SEES BUT THAT IMPORTS WILL INCREASE CONSIDERABLY LESS THAN FORESEEN BY SECRETARIAT.

(B) NUMBER OF MEASURES HAVE BEEN TAKEN RECENTLY TO REDUCE PRIVATE CONSUMPTION IN ORDER TO DAMPEN GROWTH OF IMPORTS AND OF EXPORT COSTS. NO REVERSAL EXPECTED.

(C) ROUGHLY ONE HALF OF FINANCING WILL BE OBTAINED EACH VIA GOVERNMENT BORROWING AND PRIVATE LONG-TERM INFLOWS.

(D) DELAY IN BUILD-UP OF OIL EXPORTS AND REVENUES MAKES GON MORE CONCERNED ABOUT PRESENT C/A SITUATION THAN IT WAS A YEAR OR TWO AGO. GON STILL EXPECTS OIL-LIMITED OFFICIAL USE

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PAGE 02 PARIS 16969 05 OF 06 270832Z

GENERATED C/A SURPLUS WHICH WILL BE SUFFICIENT TO REPAY DEBT, BUT THAT SURPLUS IS FARTHER AWAY THAN ANTICIPATED. THEREFORE, GON IS NOT READY TO ACCEPT CONTINUING DEFICITS OF PRESENT MAGNITUDE, IN ORDER TO MODERATE DEBT ACCUMULATION. THESE FACTORS MAKE EXTERNAL CONSTRAINT RELATIVELY MORE BINDING THAN HAD BEEN EXPECTED.

(E) UNABLE TO EXPAND INTERNAL DEMAND SINCE NORWEGIAN ECONOMY ALREADY AT FULL EMPLOYMENT, BUT MORE BUOYANT GROWTH ELSEWHERE WOULD FAVOR DOMESTIC RESTRUCTURING AS WELL AS REDUCE CURRENT ACCOUNT DEFICIT.

PORTUGAL

(A) TARGET FOR PERIOD APRIL 1978 TO MARCH 1979 IS \$1 BILLION, BUT OUTCOME MIGHT POSSIBLY BE HIGHER.

(B) PROGRAMS UNDERTAKEN IN 1977 AND MAY 1978 HAVE RESULTED IN HIGHLY RESTRICTIVE FISCAL PROGRAM. SOME INCREASE IN REAL INVESTMENT IS ENVISIONED. HIGH COST OF ADJUSTMENT WILL BE REFLECTED IN CONTINUED HIGH LEVEL OF UNEMPLOYMENT, BUT PRICES WILL NOT FALL MUCH.

(C) 75 PERCENT BY BORROWING, 25 PERCENT BY PRIVATE CAPITAL INFLOWS.

(D) LEVEL OF INDEBTEDNESS STILL ACCEPTABLE, ALTHOUGH NOT IN LONG-TERM; HOWEVER, MATURITY PROFILE IS A PROBLEM.

(E) GOP DEL ANSWERED INDIRECTLY, SAYING THAT THE STABILIZATION PROGRAM WOULD BE HARD TO DEFEND UNLESS POLICIES WERE SEEN AS LEADING TO DEVELOPMENT AND THAT LIMITED OFFICIAL USE

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PAGE 03 PARIS 16969 05 OF 06 270832Z

OTHER COUNTRIES SHOULD REALIZE ADVERSE CONSEQUENCES

OF PROTECTING THEIR INDUSTRIES.

SPAIN

SPECTACULAR IMPROVEMENT NOTED IN EXTERNAL SITUATION.  
SPANISH DEL CITED CONFIDENCE FACTORS BUT ALSO EMPHA-  
SIZED SEVERE UNEMPLOYMENT COST AND NEED FOR OECD-WIDE  
"CONCERTED ACTION" UPSWING TO PERMIT EMPLOYMENT GROWTH  
AND CONTINUED BOP STRENGTH. RESPONSES:

(A) AGREES WITH SECRETARIAT, FIRST HALF 78 C/A VERY  
STRONG BUT ECONOMY SHOULD RECOVER SLIGHTLY IN SECOND  
HALF WITH RESULTANT DETERIORATION IN TRADE ACCOUNT.

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PAGE 01 PARIS 16969 06 OF 06 270824Z  
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(B) NONE

(C-D) PROBABLY TOO MUCH CAPITAL INFLOW IN 1978  
YIELDING LARGE SURPLUS ON BASIC BALANCE; MAY USE SOME  
TO RUN DOWN ACCUMULATED DEBT.

(E) DON'T EXPECT GREATER BUOYANCY, SO HAVEN'T REALLY  
MADE PLANS.

SWEDEN

NO SUBSTANTIVE INTERVENTION.

TURKEY

(A) AGREE WITH SECRETARIAT "IN GLOBAL TERMS". DEL  
(KOC) OF PERMANENT DELEGATION) WENT ON TO SAY THAT  
SECRETARIAT'S "HESITATIONS" ARE WELL FOUNDED AND THAT  
HIGH GROWTH TARGET COULD BE RECONCILED WITH CLAMP ON  
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PAGE 02 PARIS 16969 06 OF 06 270824Z

IMPORTS SINCE: (1) GOT WOULD CONCENTRATE ON IMPORTS  
NEEDED TO COMPLETE INVESTMENT ALREADY UNDERWAY; AND  
(2) THERE IS STOCK OF IMPORTS FROM SURPLUS IN LATE  
1977 WHICH CAN BE RUN DOWN.

(B) KOC REVIEWED GOT'S ECONOMIC PROGRAMS UNDERTAKEN  
TO DATE (WHICH HAVE BEEN FULLY REPORTED ELSEWHERE).

(C) PRIVATE INFLOWS EXPECTED TO FINANCE 35 PERCENT OF  
DEFICIT, BORROWING IN MARKETS BY OFFICIAL AND SEMI-  
OFFICIAL ENTITIES 21 PERCENT, AND BORROWING FROM  
OFFICIAL SOURCES 44 PERCENT.

(D) "NOT VERY OPTIMISTIC".

(E) WOULD NOT STIMULATE DOMESTICALLY BUT RATHER TAKE  
ADVANTAGE OF GROWTH ELSEWHERE TO REDUCE DEFICIT.

IN OTHER REMARKS KOC SAID EXPORTABLE STOCKS OF AGRI-  
CULTURAL PRODUCTS WERE SIGNIFICANT AND WOULD BE  
QUICKLY SOLD, AND THAT ANOTHER BUMPER CROP IS EXPECTED.

7. OTHER BUSINESS: DATE OF NEXT TWP MEETING LEFT OPEN  
PENDING SETTING OF DATE FOR THIS EPC-RELATED MEETING.  
SALZMAN

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## Message Attributes

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Sheryl P. Walter  
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